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RUEHLP/AMEMBASSY LA PAZ 4486  
RUEHPE/AMEMBASSY LIMA 2925  
RUEHMN/AMEMBASSY MONTEVIDEO 6173  
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RUEHRG/AMCONSUL RECIFE 4572  
RUEHRI/AMCONSUL RIO DE JANEIRO 1830  
RUEHSO/AMCONSUL SAO PAULO 6693  
RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RUCPDO/DEPT OF COMMERCE WASHDC

C O N F I D E N T I A L SECTION 01 OF 03 BRASILIA 000661

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STATE PASS TO USTR FOR MSULLIVAN/KLEZNY  
NSC FOR SUE CRONIN  
TREASURY FOR FPARODI  
AID/W FOR AA/LA  
USDOC FOR 4332/ITA/MAC/WH/OLAC/JANDERSEN/ADRISCOLL/MWAR D  
USDOC FOR 3134/USFCS/OIO/SHUPKA

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TAGS: [ETRD](#) [ECIN](#) [PGOV](#) [PREL](#) [BR](#)  
SUBJECT: MERCOSUR TURNS 15 - A SOMBER QUINCEANERA

REF: A. BRASILIA 362  
[1](#)B. MONTEVIDEO 254  
[1](#)C. 3/22 2006 CRS REPORT "MERCOSUR AND U.S. TRADE  
POLICY"  
[1](#)D. 2/3/2006 CRS REPORT "BRAZILIAN TRADE POLICY AND  
THE UNITED STATES"  
[1](#)E. BRASILIA 653  
[1](#)F. MONTEVIDEO 305  
[1](#)G. BRASILIA 117

Classified By: Charge d'Affaires Phillip Chicola, based upon Reasons 1.  
5(B) and (D)

[1](#)1. (SBU) Summary. The fifteenth anniversary of the Treaty of Asuncion, which created Mercosul, took place on March 26, but was barely noticed in Brazil. Instead of an elaborate birthday celebration, the only events marking the date here were scattered ) and poorly publicized ) retrospective seminars. The reason, of course, is that the alliance is in the midst of a troubled adolescence, with intra-bloc trade lagging and junior members of the partnership rebelling against their larger neighbors. Meanwhile, economic asymmetries and political tensions make dialogue among member countries difficult. Within GOB circles, there is a vigorous debate ongoing regarding the economic usefulness of Mercosul ) though the pro-Mercosul forces continue to have the upper hand. It is too early to tell how all this will work out, but the consensus in Brazil is that intra-Mercosul relations, especially given the recent entry of Venezuela into the bloc, will get worse and may never get much better. End Summary.

Debate Within Brazil on Mercosul

[1](#)2. (SBU) Mercosul is not universally loved in Brazil. As post has previously reported (ref A), industry groups and certain government policymakers are openly questioning whether Mercosul benefits Brazil economically at all. This line of thinking posits that Brazil could export much more if it were free of the constraints imposed upon it by the Mercosul customs union; specifically, without such baggage as the Mercosul common external tariff (or its Mercosul partners in general) Brazil would have greater success negotiating

trade agreements with its main partners, such as the U.S. and the EU. The numerous exceptions of free trade within the bloc, such as the Automotive Accord, restraints on sugar, and the bilateral Brazil-Argentina safeguards mechanism (MAC), are seen by this faction as further irritants.

¶3. (SBU) However, within the GOB the dominant camp, lead by the Foreign Ministry, continues to embrace the alliance, noting that any economic negatives are more than outweighed by the political elements ) i.e., the existence of a forum for settling regional quarrels (especially between Brazil and Argentina), which gives Brazil a nearly undisputed leadership role. In addition, pro-Mercosul partisans argue that with Argentina, Paraguay, and Uruguay along for the ride, Brazil gains a force multiplier in its efforts to cement its role not only as the dominant player in South America but as the natural leader of the developing country G-20 bloc in the WTO Doha Round negotiations. Concentrating first on South-South integration, this reasoning continues, will provide Brazil greater leverage when confronting the developed world at the negotiating table.

#### Lagging Intra-Mercosul Trade

¶4. (U) Theory, unfortunately, has not coincided with reality. The level of intra-Mercosul trade has ebbed and flowed over the years in a sine-curve like fashion. In 1998, Mercosul absorbed about 17 percent of Brazilian exports. In 2005, this figure was a mere 9.9 percent. Meanwhile, as a whole, Mercosul only absorbs about 20 percent of the exports of its member countries. In comparison, the corresponding figure for intra-bloc exports within the EU is 65 percent, and for NAFTA, 70 percent.

BRASILIA 00000661 002 OF 003

#### Economic Asymmetries and Political Tensions

¶5. (U) There is no shortage of work analyzing the mediocre performance of the Mercosul bloc to date. Ref C looks at the issue in terms of asymmetries. "From the outset, Mercosu(l) struggled to reconcile a basic inconsistency of partial economic union: how to achieve trade integration, while also ensuring that the benefits would be balanced among members, and that each country would retain some control over its trade, production, and consumption structure. At the heart of the problem are the 'natural asymmetries' that exist among four economies with inherently large discrepancies in size, structure, resources endowment, and level of development . . . These differences can be compounded by 'policy asymmetries' that arise from incongruities in fiscal, monetary, industrial, exchange rate, and other policies. Either type of asymmetry can distort trade flows, causing large imbalances that threaten the stability of the agreement."

¶6. (SBU) Political and cultural tensions complicate intra-bloc relations as well. The Brazil-Argentina rivalry casts its shadow over much of Mercosul decision-making. However, there are other fault lines as well. There is no love lost between Brazil and Paraguay, as evidenced by the continuing friction over cross-border contraband and the general Brazilian disdain for things Paraguayan. (When foot and mouth disease resurfaced in Brazil in 2005, one of the first, and still most popular, explanations was contamination from unvaccinated Paraguayan cattle.) And while Uruguay and Paraguay both have issues with each other ) as do Brazil and Argentina ) the two smaller countries complain about the larger countries and vice versa. The current flap between Argentina and Uruguay (ref F) regarding the latter's construction of paper mills on a common border river is just the latest example of this. From the Brazilian point of view, Paraguay and Uruguay should just be glad that they are part of the show. As one prominent Sao Paulo business leader commented to us, "Why should we pay attention to the Uruguayans when their GDP is less than that of Santo Amaro (a

suburb of Sao Paulo and home to a number of multinational companies)?"

Enter Chavez

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¶7. (SBU) Now into this turbulent state of affairs steps Venezuela. As ref B notes, Caracas' entry will only increase the lack of coherence within Mercosul. From an economic point of view, Venezuela does not fit in as its petroleum-dominated economy provides yet another layer of asymmetry as does its Andean Community tariff structure. Trying to reconcile Venezuela's Andean Community Common External Tariffs with those of Mercosul could take years. Moreover, Brazilian industry leaders point out that removing GOV tariff barriers will not have any great differential impact as local businesses already are selling as much as they could ever expect to Venezuela. On the import side, few fear competition from what are seen as inefficient Venezuelan manufacturers.

¶8. (C) The calculation of President Lula and Foreign Minister Amorim appears to have been that Venezuelan accession would promote regional stability by subsuming Chavez within the multilateral Mercosul framework. In fact, FM Amorim recently told a visiting US delegation that Venezuela's entry into Mercosul was "more of a political hope than an economic reality." Ref G. Yet, politically, such a move threatens to increase tensions as by siding with either Brasilia or Buenos Aires the vocal Chavez could destabilize the Brazil-Argentina relationship - in a way that neither tiny Uruguay or Paraguay ever could. Moreover, a fundamental tenet of Brazilian foreign policy is that Brazil should serve as the leader of South America. If Chavez covets that role, however, then Brazil-Venezuela conflict within Mercosul is inevitable. In

BRASILIA 00000661 003 OF 003

view of the above, dissension within Mercosul is likely to get worse before it gets better.

What Does the Future Hold?

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¶9. (C) What might complicate the situation even further would be any USG move, in response to Montevideo's continuing veiled hints, to seek to initiate FTA talks with Uruguay. Such a step would enrage Brazil government officials, who would certainly see it as an effort to diminish GOB influence by splitting Mercosul. Without a doubt, both Brazilian officials and the local media would be very vocal on this point. That said, whether Brazil would take any significant actions in reply is another question. With the FTAA already at an impasse (ref E), the GOB's ability to respond on that front is limited. And given that Brazil has clearly made the success of the Doha Round its highest trade priority, it would seem counter-productive as well to retaliate in that forum. The GOB could conceivably try to compensate for the "defection" of Uruguay by speeding efforts to upgrade Bolivia to full membership. Adding Bolivia ) with all its uncertainties - to the club, however, would certainly lead to even less cohesion, especially while Brazil and the Morales government continue to spar over issues such as energy sector investment and access to natural gas.

¶10. (U) Post welcomes the opportunity to hear views from other concerned Mercosul posts and looks forward to contributing to any ongoing discussion.

Chicola